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SUBJECT: NEW ZEALAND LABOUR PARTY RETURNS NEW ZEALAND RAIL TO A  
STATE-OWNED ENTERPRISE

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11. (SBU) Summary. The Government of New Zealand (GNZ) has agreed to buy back Australian-owned Toll Holdings Ltd. rail and ferry business in New Zealand for NZ\$665 million (USD\$520million). This completes the renationalization of the railroads which a National Government privatized in 1982. National Party's opposition leader, John Key said the repurchase did not make economic sense when householders were struggling to pay higher food, power and fuel prices and said the cost to taxpayers could top NZ\$1 billion. Perhaps even more sensitive will the question of whether the Labour Party can afford to offer a long-promised tax cut after buying Toll's rail operations. End Summary.

#### Background to the Buyback

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12. (SBU) For most of its history, New Zealand's railways were administered by the New Zealand Railways Department, with the Minister of Railways being a member of Cabinet. In 1982, the Railways Department was corporatized into the New Zealand Railway Corporation. In 1990, the core rail operations of the Corporation were transferred to New Zealand Rail Limited, a state-owned enterprise (SOE). New Zealand Rail Limited was privatized in 1993, with the new owners adopting the name Tranz Rail in 1995.

13. (SBU) In 2002 shares in Tranz Rail dropped to a record low price on the New Zealand Sharemarket (NZX) as a result of its poor financial state and mismanagement. In 2003, Toll Holdings Ltd. of Australia made a successful takeover bid for Tranz Rail, subject to an agreement to sell back the rail and railbed to the government for \$1. It took over the rolling stock, freight and passenger operations. The government committed to NZ\$200 million of taxpayer funding on deferred maintenance and capital improvements via the New Zealand Railways Corporation, now called OnTrack.

#### The Buyback

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14. (SBU) The New Zealand Government this week spent NZ\$665 million to repurchase Toll's rolling stock and rail ferries; that is three times the valuation that Toll put on the trains and rail ferries when it launched its takeover for the financially stressed Tranz Rail, in 2003. Under the buyback scheme, Toll gets to keep for six-years rent-free Tranzlink's freight facilities, the company's NZ-based freight forwarding business, together with warehousing and

contract logistics operations.. According to contacts at the Australian High Commission, this six-year control of the freight forwarding operations could be worth an additional NZ\$20 million to Toll. This segment of the enterprise has been the profit-making part of Toll's business. The Government has been left with a collection of leftover assets masquerading as a business, including outdated rolling stock, one owned and two leased ferries which will (now be added to the national track the Government bought in 2003) and a rail track that is still in dire need of major investment.

#### The Reaction

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15. (SBU) The National Party criticized the purchase, saying the final cost could be over NZ\$1 billion once needed improvements are factored in. National Party leader, John Key said the purchase did not make sense when householders were struggling to pay higher food, power and fuel prices. However, if it wins this year's election, the party won't sell because it doesn't think it could get the money back and has pledged not to sell State assets. (Comment. The real reason for Key's promise not to sell is political. Labour has tried to play on voters' fears that the National Party will sell state assets if elected. Key knows that issue is a loser for National. End Comment.). A National Government sold the railways in 1993 after the previous Labour Government first transformed it into an SOE. Then Labour Transport Minister Richard Prebble (who later led the right-wing party ACT) said this new buyback would be "the most expensive purchase that the taxpayer's ever had to fund". He said Labour botched buying back the rail network and failed to first get an agreement on sharing costs with the rail operator.

#### The Way Forward

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16. (SBU) In announcing the deal, Finance Minister Michael Cullen

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said preliminary work was being done on how much more the Government would have to spend on the rail system upgrades, which would be measured "in the hundreds of millions rather than the tens of millions." Toll boss, Paul Little said "if we'd had a choice, Toll would probably have preferred not to have sold the rail and shipping assets but it had been unable to reach agreement with the Government over a raft of important issues." Prime Minister Helen Clark says the renationalized railway system will be run in a business-like manner, but the Government was not doing it for financial returns. "We are not going into this to make money," per PM Clark. Cullen has admitted the Government paid more than it would like for the rail stock, but said that when Toll bought the business 4-1/2 years ago, the Government had not been seriously looking at buying it back.

17. (SBU) According to some local journalists, the Beehive (Executive Offices) has talked about getting the country's national rail business back in Government ownership since early 2001. Despite seven years of a Labour-led government, there have been no published documents showing where a renationalized rail could add value to the development of the economy. It did not figure in the Government's 2007 sustainable transport strategy which aims to halve greenhouse gas emissions from that sector by 2040. That strategy also expected coastal shipping to double its share of the intra-regional freight market which would have boosted the country's ports businesses. There will be considerable angst if the Government uses its rail assets as a loss leader to attract business away from existing road transport operators.

18. (SBU) This buyback is being contrasted with the Government's decision to bail out Air New Zealand in 2001. Then, the GNZ did extensive analysis to backup its economic rationale for investing NZ\$885 million in the ailing national flag carrier. It had also mapped out how the airline would be governed. In contrast, the government requested business consultant Beca to do a cost-benefit analysis only after the deal for the rail had been concluded. PM Clark announced this week, "the deal was good for New Zealand but not because of its financial implications."

## Can the Government Afford a Railroad and a Tax Cut?

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¶9. (SBU) Comment. Despite the Labour Party's belief that the buyback will generate social dividends, it cannot escape the business challenges of running a profitable railroad whose chief competitor is an already established network of truck and ship transport. It is still to be determined whether the New Zealand electorate will be persuaded that the high costs warrant returning Labour to office. Most have been waiting for the income tax cut PM Clark has promised and Finance Minister Cullen has waffled on. If Cullen offers too small a cut, when next year's Budget is announced on May 22nd, this sale could come back to haunt them

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